

December 6, 2016

KEY TAKEAWAYS

First Great Britain with their referendum vote to leave the EU, then the election of Donald Trump as president of the United States, and now the defeat of Italian Prime Minister Matteo Renzi. Populist movements and anti-globalization rhetoric are abound. Financial markets around the globe are in flux until direction is known. Time will tell if the market's immediate positive reaction will continue.

Key Rates (%)

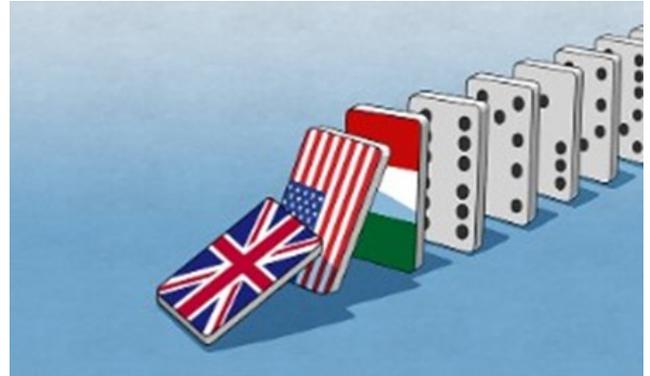
	Nov 30 2016	Oct 31 2016	Dec 31 2015
Treasury Yields			
2 Year	1.11	0.84	1.05
5 Year	1.84	1.31	1.76
10 Year	2.38	1.83	2.27
30 Year	3.03	2.58	3.02
Credit Yields			
BBB Industrial 10 Year	3.72	3.23	3.99
Muni Yields			
AAA 10 Year	2.51	1.75	2.00
Mortgage Backed Securities			
30 Year FNMA Current Coupon	3.09	2.52	3.02

NOVEMBER IN REVIEW

- High yield was the best performer despite being negative on the month, -.47% in November and +15.01% YTD.
- US Treasuries posted their fourth consecutive negative return month, -2.67% in November.
- Probabilities remain high for a December rate hike.

Shock and Awe Part Three?

First it was Brexit, then the Trump election and now Italy. Italian Prime Minister Matteo Renzi bet his political career on a referendum on whether or not the country should amend its 1948 constitution. The intent of the referendum was to drastically reduce the power of the upper house of the Italian Parliament, the Senato, by cutting its members from 300 to 100, thus reducing its power dramatically. The goal was to make the job of governing Italy less complicated, more efficient, and more productive while becoming less bureaucratic and eliminate political red tape. This would consolidate power to Rome.



The Italian economy's growth has been anemic and its GDP hasn't moved much since the 1990s. The referendum vote was a resounding "no", and Renzi kept his promise to resign. Italy may plunge into a period of instability with many Italian banks on the brink of insolvency. Italy is no stranger to political uncertainty as they have had 65 different governments since World War II. If early elections come to pass, more nationalists may come to power, in particular Beppe Grillo and his Five Star Movement.

Grillo, like President-elect Trump, has capitalized on widespread dissatisfaction with the status quo. The Five Star Movement is gaining political momentum and many fear that if Grillo comes to power in an early election, he'll call for a scrap of the Euro going back to the Lira and exiting the European Union, like Britain. The EU has been struggling with austerity, immigration from the Arab Spring uprising, and a fragile economic base.

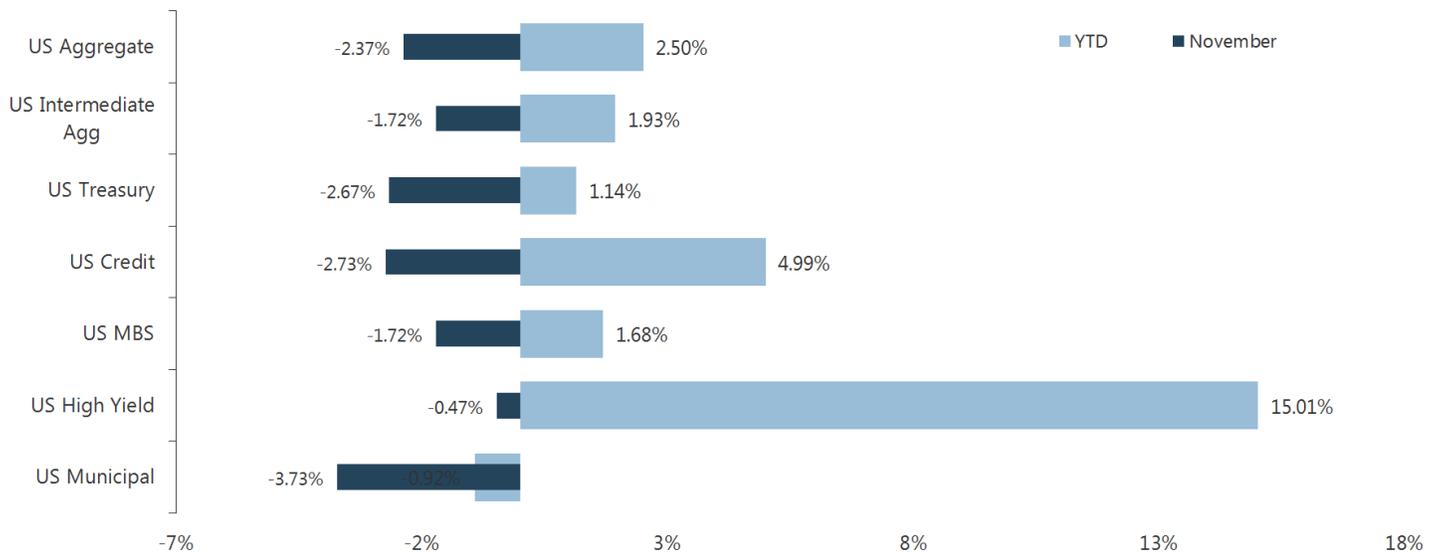
Turning to the bond market, in November there was a dramatic increase in rates across the entire Treasury yield curve as shown in **Exhibit 1** below. Interest

EXHIBIT 1: TREASURY YIELD CURVE SHIFT OVER THE PAST YEAR

Treasury	12/31/15	10/31/16	11/30/16	1-Month	YTD
2-yr Note	1.05%	0.84%	1.11%	+27bps	+6bps
5-yr Note	1.76%	1.31%	1.84%	+53bps	+8bps
10-yr Note	2.27%	1.83%	2.38%	+55bps	+11bps
30-yr Bond	3.02%	2.58%	3.03%	+45bps	+2bps

Source: Bloomberg Financial L.P.

EXHIBIT 2: FIXED INCOME MARKET PERFORMANCE



Source: Bloomberg Financial L.P. and Barclays Securities

rates rose sharply as investors priced in a December rate hike. Federal funds futures show a 100% chance of a move. November and Year-to-Date performance within the sectors of the fixed-income markets are shown in **Exhibit 2**.

The US Treasury Index has posted its fourth consecutive month of negative returns, while the Municipal Index suffered from a deluge of supply and fears of Trump's proposed tax cuts.

Going forward, we can't help but see the wave of nationalism continuing to move across the globe. First Britain, then the USA, and maybe now Italy and France may not be too far away. The EU may be on the brink of collapse again which would have devastating consequences for global financial markets. In addition, should President-elect Trump start a trade war with China, US interest rates could skyrocket as China is the

largest holder of US Treasury securities. Xenophobia, the intense dislike or fear of foreigners, is gripping many nations, mainly due to the threat of terrorism and the influx of immigrants. There is simply no playbook for this new world. The status quo as we know it has unraveled. We are ready for the growth story to play out, but we remain very cautious in both stocks and bonds, and on full alert regarding global events in this tremulous environment.

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